IN THE

Supreme Court of the United States

OCTOBER TERM 1940.

WEST SIDE TENNIS CLUB, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The undersigned, on behalf of the above-named petitioner, prays that a writ of certiorari issue to review the judgment (R. p. 110) of the United States Circuit Court of Appeals for the Second Circuit, entered May 1, 1940, affirming the decision of the United States Board of Tax Appeals (R. p. 91) entered January 21, 1939.

THE OPINIONS BELOW.

The opinion of the United States Circuit Court of Appeals for the Second Circuit (R. pp. 106-110) was promulgated April 15, 1940 and is reported in 111 Fed. (2d) 6. The findings of fact and opinion of the United States Board of Tax Appeals were promulgated January 20, 1939 (R. p. 72-90) and are reported in 39 B. T. A. 149. (R. pp. 72-91.)

JURISDICTION.

The judgment of the United States Circuit Court of Appeals sought to be reviewed was entered on May 1, 1940. Jurisdiction to issue the writ requested is found in the provisions of Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. (U. S. C. A. Title 28, Sec. 347-350.)

STATUTES AND REGULATIONS INVOLVED.

Section 103(9) of the Revenue Act of 1932 and Section 101(9) of the Revenue Act of 1934 provide:

> "The following organizations shall be exempt from taxation under this title—
> "Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

Article 530, Regulations 77 (interpreting the 1932 Act) reads as follows:

> "The exemption granted by section 103(9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes, and any profit realized from such activities is subject to tax."

Article 101(9)-1 of Regulations 86 (interpreting the 1934 Act) contains the same language as Article 530, Regulations 77, with the addition:

> "If a club otherwise exempt, sells any of its property at a profit, it is not exempt for the taxable year for which the profit is taxable."

While they are not directly involved, the Revenue Acts of 1913, 1916, 1918 and 1921 contained provisions granting exemption from tax on corporations to, "Clubs organized and operated exclusively for pleasure, recreation and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder *or member.*" (Italics ours) It is significant that the italicized words are omitted from the acts here under consideration.

The above quotation of Article 530, Regulations 77, appears in identical language in Regulations 45, 62, 65, 69 and 74 (interpreting the Acts of 1918, 1921, 1924, 1926 and 1928.)

The Commissioner has modified his interpretation of that part of the statutes dealing with exemptions for clubs by issuance of Treasury Decision 4760 (Cumulative Bulletin 1937-2 p. 128) which reads as follows:

> "Article 101 (9)-1 of Regulations 86 and Article 101(9)-1 of Regulations 94 are amended to read:
>
> "Art. 101(9)-1. *Social clubs.*—The exemption granted by section 101(9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption."

QUESTIONS PRESENTED.

I.

Was petitioner during the years 1933 and 1934 a "Club" —"operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inured to the benefit of any private shareholder", and therefore exempt from Federal income and profits taxes? Respondent, the Circuit Court and the Board agree

that it was "organized" for the exempt purposes. They hold, however, that even though since organization its charter powers have never been broadened and its fundamental activities have not changed, it is not operated exclusively for exempt purposes because it derives profits from sources other than contributions in the form of initiation fees and dues from its members. Furthermore, even though petitioner has never issued certificates of stock in any form nor distributed any of its funds to its members, the opinions below hold that the members indirectly benefit from petitioner's earnings on the ground that if they were absent the members might have to pay higher dues.

II.

If petitioner is not entitled to exemption: (a) Are the initiation fees and dues received from its members taxable income; (b) Is petitioner liable for penalties for 1933 and 1934 for failing to file returns at the times prescribed by the statutes for corporations admittedly taxable?

STATEMENT.

Petitioner was incorporated in 1902 under the Membership Corporation Law of New York "to provide and maintain lawn tennis courts and the buildings and accommodations appertaining thereto, for the use of its members, and to promote social intercourse among the members thereof." Its charter powers have never been changed. It has never issued bonds or certificates of stock of any kind and all funds received from all sources have been used to pay its maintenance expenses and debts. (Board's Findings, R. p. 73, 74.)

Petitioner had 790 members in 1933 and 751 members in 1934. All of its members were elected in accordance with its constitution and by-laws. Excepting honorary members, all paid initiation fees and each paid annual dues ranging from $20.00 to $65.00 in accordance with privilege classifications. (Board's Findings R. p. 79.) Petitioner received

fees and dues from its members in 1933 and 1934 in the sums of $44,790.00 and $42,042.75. (Ex. H, R. p. 44; Ex. I, R. p. 53.)

To carry out its charter obligations petitioner owns and maintains at Forest Hills, Long Island, for the benefit of its members and their guests, a club house with the usual recreation, dining, locker and shower rooms, twenty-eight grass tennis courts, thirty-two clay tennis courts and five fast drying tennis courts. (Board's Findings, R. p. 78.)

Petitioner's only activity other than the maintenance of its facilities for its members has been to conduct in a stadium owned by it and occupying less than one-fourth of the total area of its property, national amateur tennis tournaments and international amateur tennis matches under the auspices and with the permission of the United States Lawn Tennis Association which has been the national governing body for amateur tennis since 1881. The Association is composed of recognized tennis clubs and associations.

These matches consume a maximum of three weeks annually.

The opinions below rest on the conclusion that the conduct of such matches destroys petitioner's right to exemption. They held petitioner was not operated exclusively for the exempt purposes because the public were permitted to view the matches on payment of an admission charge. We therefore deem it necessary to elaborate on the history of petitioner's activities with respect to such matches. (Board's Findings, R. p. 73-79.)

Beginning in 1914 petitioner received from the United States Lawn Tennis Association permission to hold some of the tournaments and matches under its control and because it did not have a stadium it was necessary to hold them on turf in front of the club house; to accommodate spectators it was necessary to erect temporary stands which injured the grounds and interfered with the normal activities of the club for about three months in each year. This condition lasted until 1922.

The Association desired a permanent stadium at a recognized tennis club in which some of the important matches might be held; petitioner desired to cooperate with the Association and to continue to hold some of such matches on its property. Petitioner and the Association entered into an agreement in 1923, pursuant to which petitioner erected a stadium at a cost of $269,000.00, a large part of which was borrowed, and the Association gave petitioner permission to hold certain of the tournaments and matches in the stadium for a period of ten years. To enable petitioner to recoup the cost of the stadium, the Association granted it the right to retain a percentage of the proceeds received from the sale of tickets to spectators. Prior to expiration of the 1923 agreement a similar new agreement was executed for a further period of ten years which will expire in 1944. This was necessary to enable petitioner to pay off the balance of the cost of the stadium, the matches already held having provided insufficient funds for that purpose.

As of December 31, 1934 petitioner was indebted to the Association for $24,800.00 on account of loans received from it; it was indebted on the bond and mortgage executed when the stadium was built in the sum of $70,000.00; and it carried as a deferred liability for advance seat subscriptions the sum of $28,160.00. Its quick liquid assets amounted to $28,862.67. (See Balance Sheet, R. p. 54.)

It is not feasible for the national amateur tournaments and international amateur matches to be held at a ball park or a stadium as maintained for athletics by the colleges. The Association has never permitted such matches to be held on property other than that owned by one of its member clubs.

Petitioner has never used the stadium for other than tennis or club purposes except on three occasions.

The Commissioner of Internal Revenue was actively considering petitioner's right to exemption from a date prior to June 1934 until July 1935. Prior thereto petitioner's officers and directors believed it to be exempt. Almost

immediately after notification of a final ruling that it was not exempt petitioner filed with the Collector of Internal Revenue returns for 1933 and 1934 disclosing all of its receipts and disbursements but claiming exemption. (See Returns, Ex. H and I, with supporting papers, R. p. 48-60.)

Petitioner has always collected from purchasers of tickets for matches held in the stadium and from its members, the required taxes on admission tickets, initiation fees and dues and transmitted such taxes to the Collector of Internal Revenue. (See Board's Findings R. p. 82.)

SPECIFICATIONS OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

(1) In affirming the decision of the United States Board of Tax Appeals that petitioner is not exempt.

(2) In holding petitioner liable for taxes for the years 1933 and 1934, contrary to the provisions of Section 103(9) of the Revenue Act of 1932 and Section 101(9) of the Revenue Act of 1934.

(3) In holding that initiation fees and dues collected by petitioner from its members are taxable income.

(4) In holding that petitioner is liable for penalties for failure to file returns for 1933 and 1934 on the dates generally prescribed in the Revenue Acts of 1932 and 1934 for corporations admittedly liable for tax.

REASONS FOR GRANTING THE WRIT.

The opinion of the Second Circuit is directly contrary to the opinion of this Court in *Trinidad, Insular, Collector* v. *Sagrada Orden de Predicatores, etc.* (263 U. S. 578, 44 S. Ct. 204) which held that in considering exemption of a corporation:

> p. 581. "First, it" (the 1913 Revenue Act) "recognizes that a corporation may be organized and operated exclusively for religious, charitable, scientific

> or educational purposes and yet have a net income. Next, it says *nothing about the source* of the income, but makes the *destination* the ultimate test of exemption."

In discussing that corporation's use of its properties to produce income this Court said:

> p. 581. "Making such properties productive to the end that the income may be thus used does not *alter or enlarge the purposes* for which the corporation is created and conducted."

By contrast the Second Circuit held in this case:

> p. 8. "In the case at bar a large business bringing in a net operating income of more than half the gross income derived from the dues and ordinary activities of the club precludes an exemption of the taxpayer as a club operated exclusively for pleasure, recreation and other non-profitable purposes. The members may have enjoyed the prestige which came to their club from the annual matches, yet these matches to some extent interfered with their club privileges and were in the main simply a means of carrying the expenses of the club by means of profits obtained from the public." (R. p. 109)

It is therefore apparent that the Circuit Court interprets the statutes as depriving a club of exemption merely because of the receipt of income from sources other than the members, even though the statutes themselves provide that a club may have "earnings", which certainly does not include dues and initiation fees, and still be exempt.

Although the Circuit Court and the Board could not and did not find that any of the funds received by petitioner were *paid* by it to its *members,* they both held that the members benefited from the profits of the tournaments and matches for otherwise, "they would have had to pay larger dues or restrict club operations uncomfortably unless profits had been realized by the club from outsiders who were

willing to purchase tickets for the great annual tennis matches." (111 Fed. (2d) 6, 8; R. p. 109)

Aside from the fact the statutes do not use the word "member" but "private shareholder" the conclusion that a possible reduction in dues is the benefit contemplated by the statutes is contrary to the only cases involving the question, namely, *King County Insurance Co.* v. *Commissioner*, 37 B. T. A. 288 and *Oregon Casualty Association* v. *Commissioner*, 37 B. T. A. 340. If such conclusion were carried to its logical end, any club that might be fortunate enough to have income from invested funds or any source other than dues and initiation fees, would thereby lose its right to exemption. However, the statutes obviously contemplate receipt of earnings from some kind of financially profitable activities, otherwise it would not condition the exemption *on the use* to which such income or earnings might be devoted.

We have shown that in *Trinidad* v. *Sagrada Orden*, 263 U. S. 578, the Court said that the act "recognizes that a corporation may be organized and operated exclusively for religious, charitable, scientific or educational purposes and yet have a net income." We may paraphrase this language to apply to the present act affecting clubs as follows: The act "recognizes that a club may be organized and operated exclusively for pleasure, recreation and other nonprofitable purposes and yet have net earnings." This paraphrasing, we submit, is entirely justified because the acts are practically identical in language except that one refers to clubs and the other to religious corporations, and one uses the word "earnings" instead of the word "income."

This being the case, an entirely paradoxical situation is presented in the opinion of the Circuit Court of Appeals. It holds that because the earnings from the National tennis matches were a means of carrying the expenses of the club, the club thereby loses its exemption. But the statute, as we have shown, recognizes that a club may have earnings and still retain its exemption. If, however, a club cannot

retain its exemption if it applies these earnings to club purposes, thereby reducing members' dues, what must it do with the earnings in order to retain the exemption? To this query, we know no answer.

II.

The opinion of the Second Circuit is directly in conflict with the opinion of the Fifth Circuit in *Koon Kreek Klub* v. *Thomas, Collector* (December 28, 1939), 108 Fed. (2d) 616. Although organized in 1902 as a fishing and hunting club, Koon Kreek amended its charter to include "the raising of such livestock for profit only as the preserves of such club will maintain." This resulted from a desire to grant grazing privileges over its land for $600 per year. In 1934 oil was discovered near the club property and the club granted an oil lease at $4.00 per acre on its 6,777 acres (over $27,000) with an annual renewal rental of $1.00 per acre, ($6,777), reserving the usual royalties. The amount received from the lease was used to reduce or retire a mortgage against the club property. On this state of facts and notwithstanding respondent's regulations, the Fifth Circuit held that the club had not departed from its fundamental purposes and (p. 617) "whatever financial gain was realized was incident to and directed toward the accomplishment of the purposes upon which the exemption is based."

In the case under review the Second Circuit interprets the *Koon Kreek* opinion as holding that the amount of earnings realized from sources other than the members controls the right to exemption. That this is not so is apparent from the *Koon Kreek* opinion:

> p. 618. "The contention that the club did not operate exclusively for non-profitable purposes because of the leases of grazing rights is equally without foundation. In order to maintain its houses and preserves, it was required to raise funds from some source. That these funds might be derived from a use of the prop-

erties themselves, not inconsistent with the purposes for which they were maintained, would not change the nature of the operation any more than an increase in dues charged to members. Indeed, if the club could be made self sustaining by grazing fees, guest fees, and other perquisites, its operations being for the stated purposes, its exempt status would not be affected. We need but to extend this principle to the acquisition of the preserves themselves to demonstrate that the granting of oil leases to obtain money with which to pay the mortgage debt did not change the character of the organization."

In the case under review the Second Circuit narrowly restricts the principle established by this court in the *Trinidad* case, *supra,* to public and charitable corporations. However, the Fifth Circuit in the *Koon Kreek* case finds this unjustified and concludes that the *Trinidad* case held as we contend:

p. 618. "* * * the statute says nothing about the source of the income, but makes its destination the ultimate test of exemption."

Comparing the statutory provisions granting exemption to clubs and to charitable corporations, the Fifth Circuit continues:

p. 619. "The necessity of having money to carry on the enterprise, whether charitable or recreational, is present in both cases. Deriving funds from the properties owned to further either of these ends would be no more a departure in one case than in the other."

With regard to the contention that the earnings from the Championship matches inure to the benefit of the members because otherwise they would have to pay higher dues, the Circuit Court of Appeals, in the *Koon Kreek Klub* case had this to say:

p. 618. "This brings us to appellee's third contention, that the reduction in liabilities necessarily

resulted in a reduction in dues and assessments, or liability therefor, and therefore resulted in a benefit to the shareholders. Viewed in the light of the statute, this contention refutes itself. The obvious answer is that the exemption applies to profits so long as they are retained by the organization or used to further the purposes which are made the basis of the exemption, and are not otherwise used for the benefit of any private shareholder. The authorities relied upon by appellee on this point (5) like those cited in Note 4, supra, are cases which the original purpose of the organization was to render a service of value or benefit, not within the exemption allowed by the statute."

III.

We believe this Court must be aware of the fact that countless golf and tennis clubs throughout the country make their facilities available from time to time for tournaments, professional and amateur, which the public is permitted to attend on paying of an admission fee. Each year the United States Lawn Tennis Association permits clubs other than petitioner to hold matches and tournaments under its control on their properties. Several hundred of such tournaments and matches are held yearly.

Apart from the conflict caused by the Second Circuit, we believe this case presents a question of general importance which should be decided by this Court to enable the respondent to determine the tax situation of all clubs on a consistent basis. That is not possible in view of the opinion below in this case.

IV.

The status of initiation fees and dues paid by members to social clubs is a question of general importance to all such clubs which may be held subject to Federal taxes. It is a question which has never been directly decided although we believe it has been indirectly decided in petitioner's favor in analagous situations. (See *Valley Waste Disposal Co.* v. *Commissioner,* 38 B. T. A. 452; *Board of Fire Underwriters, etc.* v. *Commissioner,* 26 B. T. A. 860.)

We contended below that club initiation fees being non-recurring and paid but once for the privilege of membership are capital contributions.

We contended below that club dues are not taxable income because not "derived from capital, from labor or from both combined." Furthermore, they cannot be called profits as that term is generally understood, as the sole use petitioner can put them to is its maintenance and the payment of its debts. Practically, they represent nothing more than payment by each member of his proportionate share of his club's expense.

The Circuit Court does not answer either contention but decides the question solely on the fact that petitioner included the fees and dues in its income tax returns and used them to pay operating expenses. *Book entries cannot control* the status of receipts as income. Inclusion of the fees and dues in the returns was necessary for a full and honest disclosure of all of petitioner's receipts. The returns were filed with insistence upon exempt status.

V.

Although the Circuit Court fails to mention the decision in discussing the question, we believe the opinion below to be in direct conflict with the prior opinion of the Second Circuit in *Jockey Club* v. *Helvering*, 76 Fed. (2d) 597, 30 B. T. A. 670, on the question of petitioner's liability for penalties.

Respectfully submitted,

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